



OFFICE OF  
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

CC:EBEO:Br4:JMCCasey  
FREV-100575-99  
APR 26 1999

MEMORANDUM FOR Director, Exempt Organizations Technical Division  
Attention: Debra Cowen

FROM: Chief, Branch 4, Office of the Associate Chief Counsel  
(Employee Benefits and Exempt Organizations)  
CC:EBEO:Br4

SUBJECT: [REDACTED] TAM

This is in response to your assistance request of November 10, 1998, on the application of section 45B of the Internal Revenue Code to a tax-exempt organization. Specifically, you requested our opinion on whether a tax-exempt organization should compute the section 45B credit on the social security and Medicare taxes paid with respect to all tips received by its employees, or only on tips received in connection with its unrelated business activity. We apologize for the delay in responding. The facts as we understand them and our conclusion are set forth below.

Legend

Taxpayer = [REDACTED]

Date X = [REDACTED]

Date Y = [REDACTED]

Issue

Whether Taxpayer, an organization exempt from tax under section 501(c)(7) of the Code, may claim the credit under section 45B of the Code with respect to all tips received by its employees, or is the credit limited to tips received in connection with its unrelated business activity?

PMTA: 01336

FREV-100575-89

Facts

Taxpayer is a country club that is exempt from tax under section 501(c)(7) of the Code. As part of its facilities, Taxpayer has a clubhouse available to its members, where food and beverages are served. The waitstaff are paid by the hour and also receive tips, which are recorded on the sales slips. The tips are allocated by the Taxpayer to the workers and are reported on the employment tax returns filed by Taxpayer. Taxpayer pays Federal Insurance Contributions Act (FICA) taxes (social security and Medicare taxes) on the reported tips.

Taxpayer allows its members to sponsor parties. The income from these parties is reported as nonmember income on Form 990-T, Exempt Organization Business Income Tax Return. Taxpayer has filed amended Forms 990-T for tax years ending Date X through Date Y. Taxpayer claimed the credit under Code section 45B for employer social security and Medicare taxes paid on employee tips for the tax year ending Date Y. Taxpayer calculated the credit based on all tips received by its employees rather than calculating the credit only on the tips received with respect to its unrelated business activity. The excess credit was carried back to the earlier years.

Law and Analysis

Section 45B of the Code describes a business tax credit allowable under section 38 of the Code for the employer portion of FICA tax paid on employee tips.

Section 45B(a) defines the credit in terms of the "excess employer social security tax" paid or incurred by the taxpayer. Section 45B(b)(1) defines "excess employer social security tax" as any tax paid by an employer under section 3111 with respect to tips received by an employee during any month, to the extent those tips (A) are deemed to have been paid by the employer to an employee under section 3121(q) (without regard to whether the tips are reported under section 6053), and (B) exceed the amount by which the wages (excluding tips) paid by the employer to the employee during that month are less than the total amount that would be payable (with respect to that employment) at the minimum wage rate applicable to the individual under section 6(a)(1) of the Fair Labor Standards Act of 1938 (determined without regard to section 3(m) of that Act).

Section 45B(b)(2) limits the tips that can be taken into account for purposes of section 45B to those tips "received from customers in connection with the providing, delivering, or serving of food or beverages for consumption if the tipping of employees delivering or serving food or beverages by customers is customary."

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Section 45B(c) disallows any deduction for any amount taken into account in determining the credit under section 45B. Section 45B(d) allows a taxpayer to elect not to claim the credit for any taxable year.

Taxpayer has paid FICA taxes on all tips earned by its employees. These tips meet the requirements of section 45B(b)(2).

Section 45B does not prohibit tax-exempt organizations from claiming the credit, nor does it limit the credit to FICA taxes associated with an unrelated business activity. Therefore, provided the requirements of section 45B of the Code are satisfied, a tax-exempt organization is allowed to calculate the section 45B credit on the basis of all tips received by its employees, not just the tips received in an unrelated business activity.

Conclusion

Taxpayer may claim the credit under section 45B of the Code with respect to all tips received by its employees.



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Mark Schwimmer



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APR - 3 2000

CC:EBEO:Br4JMCCasey  
FREV-118214-99

MEMORANDUM FOR DIRECTOR, EXEMPT ORGANIZATIONS DIVISION

T:EO

Attn: Charles Barrett or Debra Cowen

Hand Copy to [illegible]

FROM: Assistant Chief Counsel  
(Employee Benefits and Exempt Organizations)

SUBJECT: Reconsideration of TAM 199931041 [REDACTED]

This is in response to your November 8, 1999, request that we reconsider conclusion in the above referenced TAM. The TAM concluded, in relevant part a tax-exempt organization is allowed to calculate the section 45B credit on the basis of all tips received by its employees, not just tips received in an unrelated business activity. The TAM was based on an April 26, 1999, memorandum from this office.

[REDACTED]

Section 45B is one of the credits that make up the general business credit under section 38. Section 38 does not provide a general rule for the application of the business credit to tax-exempt organizations. Section 45B is silent about its application to a tax-exempt organization. In contrast, Congress has specifically limited four of the other credits in cases involving tax-exempt organizations. These are the Investment Credit, the Work Opportunity Credit, the Welfare-to-Work Credit, and the Empowerment Zone Employment Credit. Because Congress has

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<sup>1</sup>Both our April 26, 1999, memorandum and your November 8, 1999, request refer to all tips received by a tax-exempt organization employees. We note that "all tips" refers to only those tips that meet the requirements of section 45B (e.g., tips received in connection with the providing, delivering or serving of food or beverages for consumption if the tipping of employees is customary).

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not limited the section 45B credit in cases involving tax-exempt organizations, we continue to believe that the section 45B credit calculation should be made with respect to all tips received by a tax-exempt organization's employees.

You suggest that [REDACTED]  
[REDACTED]  
[REDACTED]

[REDACTED] a section 501(c)(7) social club, is subject to employment tax on tips earned by its employees with respect to both exempt functions and unrelated trade or business activities. Section 512(a)(3)(A) limits the deductions that may be taken against unrelated business income of a section 501(c)(7) organization to deductions directly connected with the production of gross income. However, section 512(a)(3)(A) does not address credits.

We believe it would be an impermissible extension of the scope of section 512(a)(3)(A) to equate a deduction with a credit. A credit reduces a taxpayer's federal income taxes on a dollar-for-dollar basis, whereas a deduction reduces a taxpayer's income subject to tax. Moreover, neither section 38 nor section 45B includes the "directly connected with" limitation of section 512(a)(3)(A). Accordingly, we believe that TAM 199931041 reached the correct result.

[REDACTED]  
[REDACTED] The section 45B credit is a non-refundable credit. The rules set forth in section 38 govern the extent to which the section 45B credit may be used in a taxable year or as a carryback or carryforward. If the tax-exempt social club in your example never has unrelated business activities, then it will never be able to use the section 45B credit.

If you have any further questions, please contact Jean Casey at 622-6060.

  
MARY OPPENHEIMER